

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. (This is a GIL).

March 22, 2000

Dear Xxxxx:

This letter is in response to your letter dated February 3, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is a provider of aviation repair and service for corporate jet aircraft with facilities situated at the AIRPORT. The services provided can be extensive and quite costly given the technical knowledge required and quality of materials transferred into the final product. As a serviceman, we understand the provisions of the Service Occupation Tax as they relate to our business and have been diligent in our efforts to properly collect and remit the appropriate amount of tax to the Department. Furthermore, we have been audited numerous times by your agency and make ample use of the communication made possible by repeated field visits.

As for the situation at issue, we have been asked by a customer in STATE to request a refund for tax paid in error as they do not feel that Illinois tax should have been charged given the nature of the transaction involved. Accordingly, subsequent contact was made with your office to request a claims package so that the paperwork could be completed and put into motion to show the customer our good faith in attempting to address their concerns. However, in follow-up discussions with your audit personnel, I was informed that in order to request a claim for credit, COMPANY would have to show that the tax monies had been unconditionally reimbursed to the customer. Otherwise, the claim would be denied for that reason alone. The real issue concerning the applicability of Service Occupation Tax would not be addressed. I was instead advised that the more appropriate route to take would be to draft a letter to the Legal Services Office asking for clarification in this matter. (As a side note, we are not currently under audit for the period in question.)

Accordingly, the following represents the facts of the transaction which took place last year with tax being charged and later remitted by the customer under protest:

BUSINESS, a STATE corporation, entered into a contract with COMPANY to perform avionics, interior and paint work on an aircraft leased by BUSINESS from CORPORATION of CITY/STATE.

The aircraft was input into the CITY facility in December of 1998 with the work being completed in February of 1999. In accordance with the payment terms of the contract, an input invoice was prepared and sent to BUSINESS shortly after the proposal was signed and returned to COMPANY by BUSINESS. BUSINESS then contacted COMPANY and requested that the input invoice, as well as all subsequent invoices be billed to CORPORATION. COMPANY complied with this request. The final invoice was sent to CORPORATION for payment on behalf of BUSINESS in February and reflected approximately \$30,800 in SOT due on the selling price of materials transferred in connection with service work performed on the aircraft.

BUSINESS and CORPORATION subsequently protested the tax on the final billing stating that the transaction was not subject to Illinois tax since the aircraft was domiciled in the STATE. CORPORATION then provided a STATE Sales/Use Tax Certificate of Exemption stating that the aircraft was being leased and that STATE sales/use tax was being paid on the rental stream. CORPORATION also provided COMPANY with a copy of the Master Equipment Lease between CORPORATION (Lessor) and NAME (Lessee) indicating that a true lease did in fact exist between the two parties.

COMPANY then contacted audit personnel from the Department of Revenue to once again make certain that COMPANY's position was correct and that Illinois law viewed the lessor to be the user of tangible personal property in question. This being true, tax was appropriately due since NAME (lessee) had flown the aircraft into Illinois for repair and had subsequently flown the aircraft from Illinois to STATE.

COMPANY then contacted CORPORATION to inform them that Illinois would not honor a STATE certificate of resale as they were viewed to be the user of the property. Accordingly, CORPORATION then submitted a completed Certificate of Resale to COMPANY reflecting the sale to be for resale along with a current Illinois IBT Number.

Once again, audit personnel from the Department were contacted by COMPANY to see whether or not a subsequent certificate with Illinois registration could be accepted as proof that no tax was due on the transaction in question. This time, COMPANY was informed that a leasing company is prohibited from giving a resale certificate in situations where a true lease is involved and since COMPANY had been informed of that relationship, then they could not, in good faith, accept such a certificate from an out-of-state lessor.

CORPORATION was then notified of the answer provided by the Department and they in turn requested that COMPANY make a formal request for refund of the taxes paid by COMPANY and refund that amount to CORPORATION.

In conclusion, COMPANY respectfully requests that a written and binding opinion be secured from the Department of Revenue reflecting that COMPANY has, in fact, applied to the Illinois tax regulations appropriately as it relates to the above transaction. Attached you will find CORPORATION'S written request to COMPANY in an attempt to get tax monies surrendered back to them. COMPANY still feels that it has correctly charged tax in this situation but it also sees the need to have it's position substantiated or refuted in writing by the Illinois Department of Revenue.

In consideration of our customer's desire to resolve this issue, COMPANY also requests that this review and opinion be handled as expeditiously as possible. If any additional information is required by your office, either from CORPORATION or COMPANY, please feel free to contact me by phone at #####. I can also be reached by e-mail at #####.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they

incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. They collect the corresponding Service Use Tax from their customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

If servicemen incur Service Occupation Tax, their lessor customers incur the corresponding Service Use Tax, which must be collected by the servicemen. Lessors may not provide Certificates of Resale for the items of tangible personal property that are transferred to them incident to the provision of a service, unless they will resell that property. As explained below, Illinois considers lessors under true leases to be the users of the tangible personal property purchased for leasing purposes. They cannot claim the resale exemption for items purchased or repaired for leasing purposes.

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible

personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

If a taxpayer files a claim for credit for an amount of tax that is not due, either as a result of a mistake of fact or an error of law, no credit shall be given the taxpayer unless the taxpayer shows that it has borne the burden of the tax or has unconditionally repaid the amount of the tax to the customer from whom it was collected. See the enclosed copy of 86 Ill. Adm. Code 130.1501. Only the persons remitting tax to the Department are authorized to file such claims. Under Illinois sales tax laws, retailers are not required to file claims for credit. Further, the Department has no authority to compel sellers to file a claim for credit. Whether or not sellers refund the taxes paid and file claims for credit with the Department is a private matter between sellers and purchasers.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk

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Enc.